

Message Text

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TREASURY FOR MARESCA

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SUBJ: PERU'S FINANCIAL CRISIS: ANALYSIS OF PUBLIC SECTOR DEFICIT
AND REAL WAGE IMPACTS OF RECENT GOP AUSTERITY MEASURES

REF: (A) LIMA 4525, (B) LIMA 4211, (C) LIMA 4045, (D) LIMA 4312,
(E) MARESCA/SMITH TELECON 5/18/78

1. SUMMARY: NEW AUSTERITY MEASURES SHOULD REDUCE NET PUBLIC SECTOR DEFICIT BY SOME 41-42 BILLION SOLES IN 1978 (31-32 BILLION SOLES AS NET FISCAL IMPACT PLUS ABOUT 10 BILLION SOLES IN NEW REVENUES FOR STATE OIL MONOPOLY PETROPERU). IMPACT OF NEW MEASURES ON REAL WAGES IS NEGATIVE, AND THE AVERAGE WORKER (WHOSE REAL WAGES HAVE BEEN IN MORE GRADUAL DECLINE SINCE 1974) WILL SUFFER A 10-15 PERCENT DROP IN REAL WAGES IN FIRST HALF 1978 IF AUSTERITY MEASURES HOLD AND NO FURTHER WAGE INCREASES ARE ALLOWED. END SUMMARY.

2. IMPACT OF NEW MEASURES ON PUBLIC SECTOR DEFICIT. LATEST GOP PROJECTION OF FISCAL DEFICIT IN THE ABSENCE OF THE NEW AUSTERITY PACKAGE WAS 76.8 BILLION SOLES
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(WITH REVENUES PROJECTED AT 217.0 BILLION AND EXPENDITURES AT 293.8 BILLION). INCREASED NET EXPENDITURE ATTRIBUTED BY GOP TO NEW MEASURES IS 7.1 BILLION, MOSTLY DUE TO PUBLIC SECTOR WAGE INCREASES. READJUSTMENT OF EXPENDITURE CALCULATIONS ON BASIS OF 150/\$ EXCHANGE RATE (VICE 130/\$) ADDS ANOTHER 7.5 BILLION SOLES FOR A TOTAL PROJECTED EXPENDITURE INCREASE OF 14.6 BILLION. GOP ESTIMATES THAT

REVENUES WILL INCREASE BY 41 BILLION SOLES DUE TO NEW MEASURES, AND THAT AN ADDITIONAL 5.1 BILLION SOLES WILL BE PICKED UP DUE TO THE EXCHANGE RATE MOVEMENT TO 150 0/0\$, FOR A TOTAL OF 46.8 BILLION SOLES. ACCORDING TO GOP, THIS HAS THE NET EFFECT OF REDUCING THE CENTRAL GOVERNMENT FINANCIAL GAP FROM 76.8 BILLION SOLES TO 44.6 BILLION, I.E. BY SOME 32.2 BILLION SOLES. OUR OWN CALCULATIONS GENERALLY CONFIRM GOP ESTIMATE OF NET FISCAL IMPACT--WE ARRIVED AT 31.2 BILLION SOLES DUE TO DIFFERING ESTIMATES OF EXPENDITURE IMPACT FOR REMOVAL OF FOODSTUFF SUBSIDIES AND REVENUE IMPACT OF NEW TAX MEASURES. IN ADDITION TO ABOVE FISCAL IMPACT, GOP ESTIMATES THAT PETROPERU, THE STATE OIL MONOPOLY, WILL RECEIVE ABOUT 9.6 BILLION SOLES IN ADDITIONAL REVENUES FROM THE INCREASED PRICES ON PETROLEUM PRODUCTS WHICH WAS A PART OF THE NEW AUSTERITY PACKAGE. THIS BRINGS THE GOP-ESTIMATED TOTAL EFFECT ON THE PUBLIC SECTOR DEFICIT OF THE NEW MEASURES TO 41.8 BILLION SOLES AND TO 40.8 BILLION SOLES BY OUR CALCULATIONS. CAVEAT: THESE INITIAL CALCULATIONS WILL BE SUBJECT TO REVISION IN COMING MONTHS. THEY COULD BE ALTERED SIGNIFICANTLY BY A NUMBER OF FACTORS, INCLUDING THE ANTICIPATED FURTHER MOVEMENT IN THE EXCHANGE RATE FROM 150/\$ TO PERHAPS 180/\$ (REF A), OR FURTHER WAGE INCREASES RESULTING FROM CONTINUED SOCIAL UNREST AND LABOR DEMANDS (SEE BELOW).

3. DECLINE IN REAL WAGES--FIRST HALF OF 1978. THE WAGE LIMITED OFFICIAL USE

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INCREASE EFFECTIVE MAY 9, 1978 FOR PRIVATE SECTOR EMPLOYEES WAS 1,500 SOLES PER MONTH APPLIED ACROSS-THE-BOARD (SEE REF B). AVERAGE PRIVATE SECTOR WAGES ARE CURRENTLY IN THE RANGE OF 15,000 TO 20,000 SOLES PER MONTH. THE LIMA CONSUMER PRICE INDEX (CPI) HAS INCREASED THIS YEAR AS FOLLOWS: JANUARY 1978, 7.46 PERCENT; FEBRUARY, 4.99 PERCENT; MARCH, 2.49 PERCENT; APRIL, 2.41 PERCENT. WE NOW EXPECT MAY AND JUNE CPI MOVEMENTS TO BE ON THE ORDER OF 5-7 PERCENT FOR EACH MONTH DUE TO IMMEDIATE IMPACT OF INCREASED PRICES OF FOODSTUFFS AND BUS FARES AND THE LESS-IMMEDIATE IMPACTS OF TRANSPORTATION CHARGES, EXCHANGE RATE MOVEMENT, AND WAGES. WE ESTIMATE THE IMMEDIATE IMPACT OF FOODSTUFF PRICE INCREASES AT ABOUT 5.3 PERCENT AND THE IMMEDIATE IMPACT OF THE INCREASE IN BUS FARES, ELECTRICITY AND GASOLINE AT ABOUT 4.5 PERCENT. (THE MAY CPI INCREASE WILL NOT PICK UP FULL IMPACT OF THESE INCREASES BUT WE EXPECT THAT THE JUNE CPI WILL DO SO.) THE FULL CPI IMPACT OF MAY AND JUNE WILL BE ON THE ORDER OF 12-15 PERCENT. A 12 PERCENT IMPACT WOULD MAKE JUNE CPI 32.6 PERCENT HIGHER THAN DECEMBER 1977 AND A 15 PERCENT IMPACT WOULD MAKE JUNE CPI 36.1 PERCENT HIGHER THAN DECEMBER 1977. EXCEPT FOR WORKERS WITH VERY LOW PAY, THE 1,458 SOLES PER MONTH INCREASE EFFECTIVE JANUARY

1, 1978 AND THE 1,500 SOLES PER MONTH INCREASE EFFECTIVE ON MAY 9, 1978, SIGNIFY REDUCTIONS OF REAL WAGES BECAUSE TAKEN TOGETHER THEY ARE EQUIVALENT TO NOMINAL WAGE INCREASES OF ONLY 1520 PERCENT BASED ON AVERAGE PRIVATE SECTOR REMUNERATION. WITHOUT FURTHER WAGE INCREASES DURING THE FIRST HALF OF 1978, THE OUTCOME WOULD BE A REDUCTION IN REAL WAGES FOR THE AVERAGE WORKER OF ABOUT TEN PERCENT, WITH THE IMPACT ON THE HIGHER-PAID, MORE SKILLED WORKER BEING EVEN GREATER.

4. REAL WAGES HAVE BEEN DECLINING SINCE 1974. AS IS NOTED IN LIMA'S A-188 (NOVEMBER 14, 1977), CENTRAL BANK ESTIMATES FOR ALL WORKERS INDICATE A DECLINE OF 0.8 PERCENT IN 1975, AND 2.1 PERCENT FOR 1976. FOR 1977, EVIDENCE IS NOT AS LIMITED OFFICIAL USE

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FIRM. THE INDEX OF REAL WAGES FOR AVERAGE PUBLIC SECTOR REMUNERATION FOR DECEMBER 1976 TO DECEMBER 1977 DECLINED BY 11 PERCENT. EVEN THOUGH THESE DATA DO NOT REFLECT INCREASES IN FRINGE BENEFITS THEY SUGGEST LARGER DECLINE THAN PREVIOUS YEARS. ALL EVIDENCE AVAILABLE TO US INCLUDING AN ANALYSIS OF THE REAL WAGES OF EMBASSY PERSONNEL, WHOSE WAGE SCALES ARE GEARED TO PRIVATE SECTOR EMPLOYEES, SUGGESTS THAT THE DECLINE IN REAL WAGES HAS BEEN MORE SEVERE FOR UPPER INCOME WORKERS THAN FOR LOWER INCOME WORKERS AND THAT FOR WORKERS NEAR THE MINIMUM WAGE, REAL WAGES HAVE NOT DECLINED AND MAY HAVE INCREASED SLIGHTLY. OUR CONCLUSION IS THAT REAL WAGES OF THE AVERAGE WORKER ARE LIKELY TO DECLINE BY 10-15 PERCENT IN PERU THE FIRST HALF OF THIS YER, FOLLOWING A GRADUAL DECLINE SINCE 1974. DECON 5-26-79. SHLAUDEMAM

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